

Tax Provisions of the American Families Plan

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On Wednesday, April 28th, the White House announced the [American Families Plan](#), the “human capital” infrastructure proposal. The American Families Plan would spend \$1.8 trillion, including \$800 billion in tax cuts over ten years, offset by \$1.5 billion in new taxes over the same period. This blog summarizes the tax provisions of the American Families Plan.

Tax Cuts

The American Families Plan proposes extending the expanded Affordable Care Act premium tax credits and the expanded Child Tax Credit enacted under the American Rescue Act, and making the Child Tax Credit, the Child and Dependent Care Tax Credit, and the Earned Income Tax Credit fully refundable on a permanent basis.

Increased Individual Ordinary and Capital Gains Top Rates

The American Families Plan would increase ordinary income rates from 37% to 39.6%, which when added to the 3.8% Medicare tax, would be 43.4% for the top ordinary income tax bracket. The capital gains tax rate for households over \$1 million would be increased from 20% to 39.6%, which, including the 3.8% Medicare tax, would also be 43.4%. If this proposal is enacted, taxpayers will tend to hold their appreciated property rather than sell it and increasingly use financial products, such as prepaid forward contracts and costless collars, to reduce risk and monetize their appreciated publicly-traded positions.

Limiting Section 1014 Step-Up Basis at Death

Very generally, under section 1014, heirs acquire a decedent's assets with a "stepped up" basis equal to fair market value so that the assets may be sold without income tax. The American Families Plan proposes to end "stepped up basis" under section 1014 for gains in excess of \$1 million (or \$2 million per couple).^[1] Although the proposal is phrased as simply ending stepped up basis, it has been widely reported that the proposal would treat death as a realization event (i.e., upon death a decedent would be treated as if all of his or her assets were sold and the gain in excess of the \$1 million/\$2 million threshold would be subject to tax).^[2] The American Families Plan also proposes that, for family-owned businesses and farms that are given to heirs who continue to run the business, tax on the appreciation would be due only upon a sale or when they are no longer family-owned and operated. It has been reported that a 15 year fixed-rate payment plan would be available for the taxes on certain illiquid assets.^[3] No tax would be due for a gift to charity. Consequently, and as a result of the increased capital gains rates, gifts to charities would become much more attractive than under current law.

End Capital Gain Treatment for Carried Interests

Under current law, a partner who receives a share of future profits of (or a "carried interest in") a partnership in exchange for services is not subject to income tax upon receipt and may be allocated capital gains from the partnership or realize capital gains upon a sale of the carried interest. Generally, under section 1061, certain holders of carried interests are entitled to long-term capital gains treatment only if they satisfy a three-year holding period (rather than the normal one-year period).

As mentioned above, the American Families Plan proposes to increase the highest marginal long-term capital gains rate so that it is equal to the highest marginal ordinary income rate. In addition, the American Families Plan proposes to "close the carried interest loophole so that hedge fund partners will pay ordinary income rates on their income just like every other worker." It is, however, unclear whether the proposal will apply to all carried interest or only the carried interests currently subject to section 1061, and it is unclear what the mechanism for the change will be. If carried interests are taxable at ordinary income rates, we expect fund managers increasingly to receive their compensation in the form of deferred compensation. Finally, changes to the capital gains rate eliminate the benefits of issuing stock compensation, as capital gains would be taxable at the same rate as ordinary income.

End Section 1031 Like-Kind Exchanges

The American Families Plan proposes to end section 1031 tax-free like-kind exchanges for real estate gains in excess of \$500,000. If this proposal is enacted, we expect real estate investors will use up-REIT structures and leveraged distributions to diversify and achieve liquidity for their appreciated real estate holdings.

3.8% Medicare Tax Reform

Under current law, limited partners and S shareholders can avoid paying the 3.8% Medicare tax on business income. The American Families Plan indicates that it would expand the 3.8% Medicare tax to apply to all those earning over \$400,000.

Make Permanent the Section 461(l) Limitation on Excess Business Losses

Under section 461(l), business losses in excess of \$250,000 (or \$500,000 for a joint return, both indexed for inflation) that are not deductible become net operating losses. Section 461(l) will expire in 2026. The American Families Plan would make section 461(l) permanent.

No Repeal of the Cap on Social Security Taxes

Under current law, employers and employees are each subject to a 6.2% social security tax (for a total of 12.4%) and self-employed individuals are subject to a 12.4% social security tax on their first \$142,800 (in 2021) of wages. It had been reported that the Biden Administration would lift the cap so that the social security tax applied to all wages and self-employment income. This proposal was not in the American Families Plan.

No Change to the Gift and Estate Taxes

The American Families Plan does not propose any change to the gift and estate taxes.

No Repeal of the SALT Limitation

Currently, only a maximum of \$10,000 annually of state and local taxes (SALT) are deductible from federal income. The American Families Plan does not propose to change the SALT limitation.

Dramatic Increase in Tax Enforcement for High-Income Taxpayers

The American Families Plan proposes to dramatically increase IRS funding (by \$80 billion, according to news reports^[4]) and audit rates for taxpayers earning more than \$400,000. The American Families Plan also proposes to give the IRS authority to regulate paid tax return preparers and require financial institutions to report financial account cash flow to the IRS.

[1] In addition, individuals would be able to exclude \$250,000 (and couples \$500,000) of gain from a principal residence, as is the case under current law.

[2] [Biden's Capital-Gains Tax Plan Would Upend Estate Planning by the Wealthy - WSJ](#)

[3] [Biden's Capital-Gains Tax Plan Would Upend Estate Planning by the Wealthy - WSJ](#)

[4] [Biden Seeks \\$80 Billion to Beef Up I.R.S. Audits of High-Earners - NY Times.](#)

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